

Consolidation, Associates, Joint Ventures (IAS 27, 28, 31)

Lets begin...



Bird's eye view.....



Indian GAAP

AS 21 – Consolidated Financial Statements
(Mandatory only for listed entities - SEBI)

AS 23 – Accounting for Investments in
Associates in Consolidated financial statements

AS 27 – Financial Reporting of Interest in Joint
Ventures

ASI 18 - Consideration of Potential Equity
Shares for Determining whether an Investee is
an Associate under AS 23

ASI 24 – Definition of 'Control'

ASI 26 - Accounting for Taxes on Income in
Consolidated Financial Statements

IFRS

IAS 27 – Consolidated and
Separate financial statements
(Mandatory for all entities)

IAS 28 – Investments in Associates

IAS 31 – Interest in Joint Ventures

IFRS 3 – Business Combinations

SIC 12 – Special Purpose Entities

OBJECTIVE



*'is to enhance the **relevance**, **reliability** and **comparability** of the information that a parent entity provides in its separate FS and in its consolidated FS'*

Specifically:

- Preparation and presentation of consolidated FS for a group of entities under the control of a parent; and
- Accounting for investments in subsidiaries, jointly controlled entities, and associates when an entity elects, or is required by local regulations, to present **separate** (non-consolidated) FS.



Important Definitions:-

Consolidated financial statements are the financial statements of a group presented as those of a single economic entity.



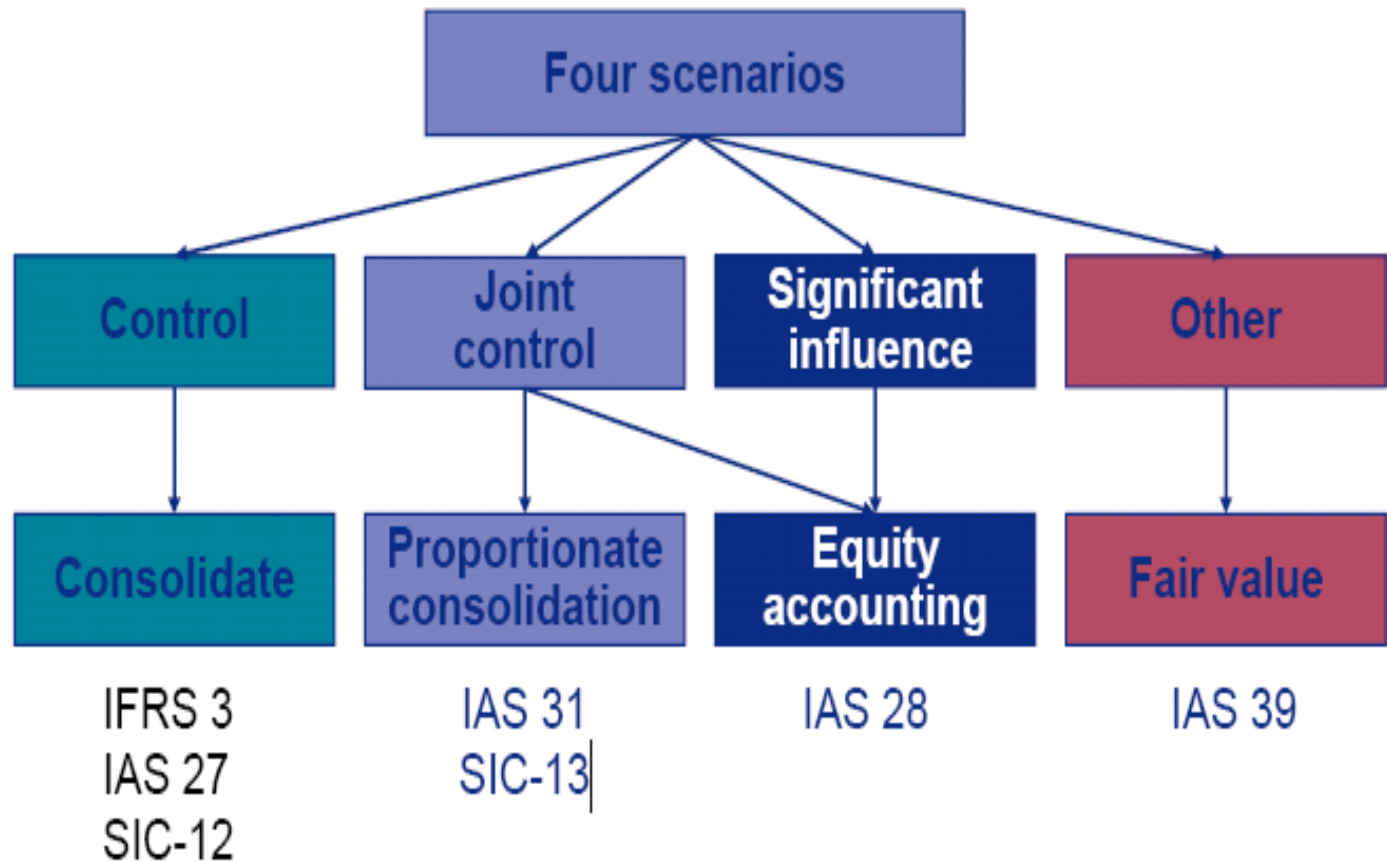
Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to a parent.

Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

A **subsidiary** is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

Methods of accounting for investments



- In practical scenario, its very difficult to judge the intentions of the management.
- If they wish to boost the top line, they would say that the entity is a subsidiary.....if you argue as auditors they might settle for JV.
- So there's lot of juggling....



Scope Exclusions

- Under IAS 27, Standard does not deal with business combinations and their effect on consolidation including goodwill arising on consolidation.
- Under Indian GAAP, acquisition of controlling interest including Goodwill is specially dealt with AS 21 “Consolidated Financial Statements” and AS14 separately deals with amalgamations and merger.





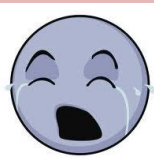
- As per Indian GAAP, Accounting for goodwill or capital reserve on consolidation is prescribed under AS 21 - Consolidated Financial Statements
 - Requires amortization of Goodwill in case of amalgamation (AS-14)
 - Entities have possibilities of reversal of impairment losses on goodwill in subsequent periods
- Under IFRS, Accounting for Goodwill or Negative goodwill whether on consolidation or business combination is prescribed under IFRS 3 – Business Combination
 - Prohibition of amortization of Goodwill; only tested for impairment
 - Prohibits reversal of impairment losses on goodwill in subsequent periods



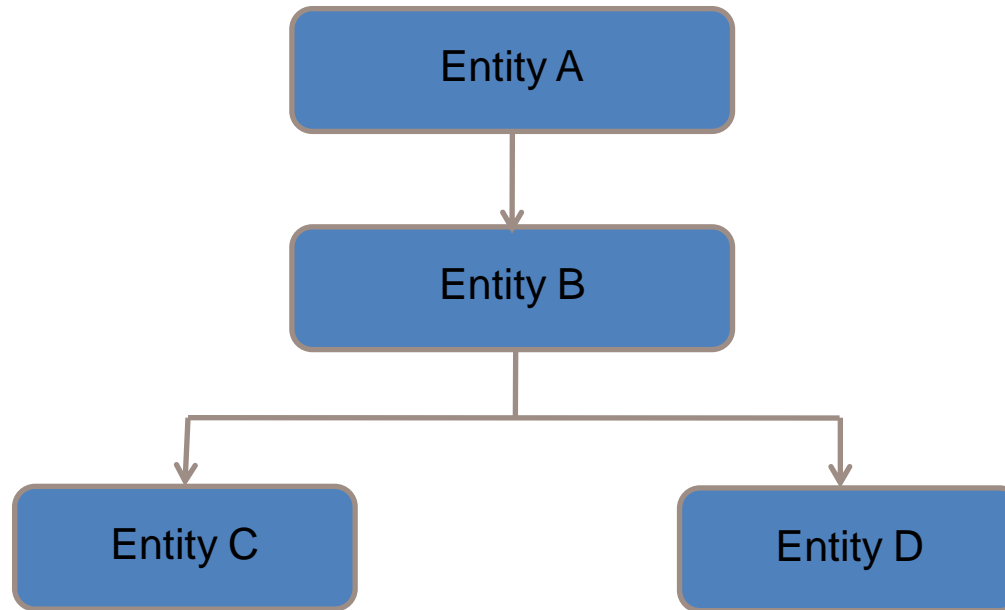
Mandatory Consolidation

- **Mandatory Consolidation - *Exceptions*** subject to satisfying below conditions
 - the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, do not object to the parent not presenting CFS;
 - debt/equity are not publicly traded of the parent
 - Parent is not planning a public issue of any of its securities and
 - the ultimate or immediate parent produces IFRS compliant CFS available for public
- The application of equity method for associates/Joint ventures is mandatory even if an entity does not have subsidiary.
- **Second Carve OUT -**

NOC



Case Study



Whether Entity B has to prepare consolidated financial statement ?

Yes, if Entity B, if partially owned then, such owners object to, not presenting CFS

Yes, if Entity B is listed or is in process of listing

Yes, if Entity A, the ultimate parent company is not presenting CFS for public use that comply with IFRS



Mandatory Consolidation

Subsidiary operates under severe long term restrictions

- Indian GAAP – Exemption from consolidation
- IFRS – No exemption



Investment in subsidiaries for temporary purpose or held for sale

- Indian GAAP – Exemption from consolidation
- IFRS – Does not give exemption from consolidation except investment in subsidiary meets the criteria to be classified as held for sale, in that case it shall be accounted for as per IFRS 5, Non-current Assets held for Sale and Discontinued Operations.



Definition of Control



- **Control** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- Specific guidance on the following from control perspective;
 - Potential voting Rights (PvRs) & Special purpose Vehicle (SPEs)
- As per Indian GAAP — Accounting Standard (AS) 21 *Consolidated Financial Statements*, **Control** means
- (i) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or
- (ii) control of the composition of the BOD in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities



Case Study

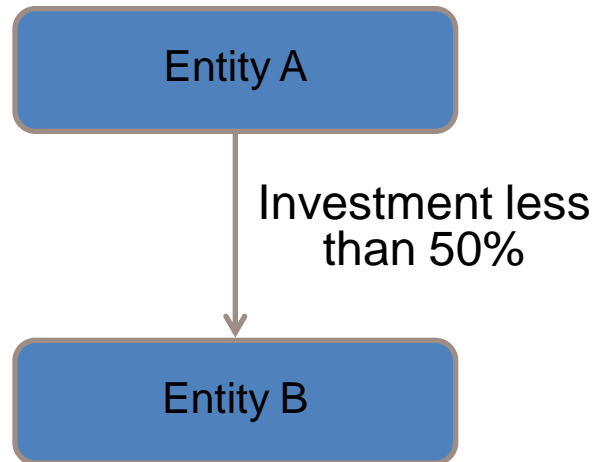


Which Entity will apply Standard on consolidation as per ?

- Indian GAAP
- IFRS



Case Study



Entity A has no control over the board of director, however it governs financial and operating policies

Whether Entity B needs to be consolidated in Entity A ?

- IFRS
- Indian GAAP



Potential voting Rights

- Definition of PvRs: An entity may own securities that are *convertible into ordinary shares* or other similar instruments that *have the potential*, if *exercised or converted*, to give the entity voting power or reduce another party's *voting power* over the *financial and operating policies* of another entity.

- **Examples of PvR:** Some of the key instruments that are considered to have potential voting rights are as under:

- Equity Share Warrants
- Share Call Options
- Convertible Preference Shares
- Convertible Debts



Potential voting Rights

Salient Features of PvR

- Convertible instruments
- Currently exercisable/convertible
- Intention of management should not be considered
- the proportion allocated to parent/non-controlling interests (or equity %) should be based only on *present* ownership interests.



Indian GAAP

- AS 21 does not specifically exclude potential voting rights, Accounting Standards Interpretation (ASI) 18 states that the effects of potential voting rights are not to be considered for the purpose of determining control with respect to Investments in Associates (AS 23)



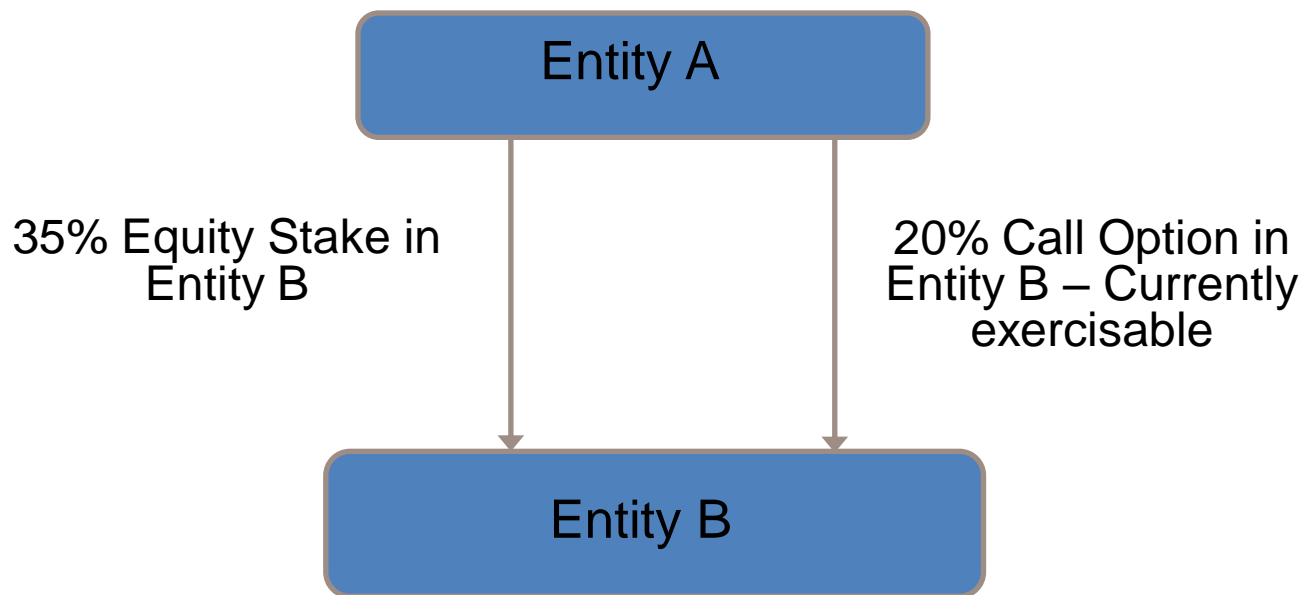
Can one subsidiary have two parents ?

Therefore, when two or more entities each holding significant voting rights, both actual and potential, the factors are reassessed to determine which entity has control.

Can non-convertible Preference Share Holders have potential voting rights ?

- A combined impact of IFRSs and legislations like the Companies Act may give rise to unique circumstances. For instance, in the Indian scenario, non convertible preference shares may have a role to play in determining control, as described below.
- As per S. 87(2)(b) of the Companies Act, 1956, every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, be entitled to vote on every resolution placed before the company at any meeting, if the dividend due on such capital or any part of such dividend has remained unpaid :

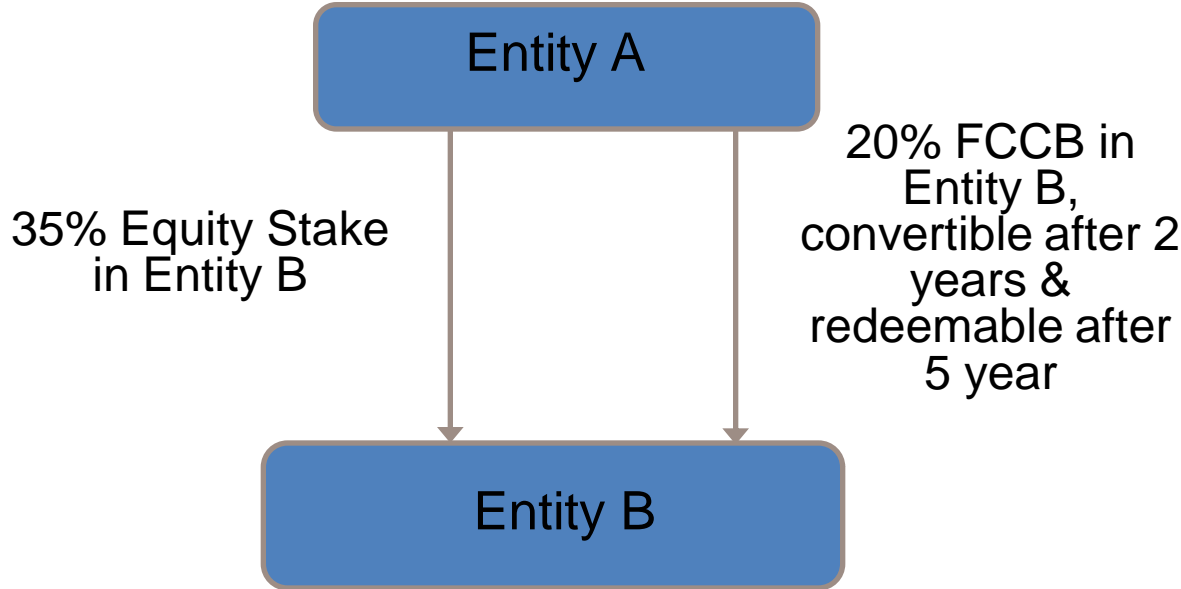
Case Study



Will this lead to consolidation as per IAS 27?



Case Study



Will this lead to consolidation as per IAS 27?

The existence and effect of only those potential voting rights that are *currently exercisable or convertible are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity.*

Potential voting rights are not currently exercisable or convertible when they cannot be exercised or converted until a future date or until the occurrence of a future event.



Deferred tax on consolidation

- As per IAS 27, Company need to calculate deferred tax assets or liability on consolidation of the group under
 - Foreign Currency Translation Reserves (FCTR)
 - Inter company Transactions
- **Under Indian GAAP**
 - Aggregation of the deferred taxes of all the subsidiaries for preparation of CFS
(As per ASI 26 “Accounting for Taxes on Income in Consolidated Financial Statements”)



Case Study – Foreign Currency Translation Reserve

Holding Company	
Net Assets	Rs. 7,000

Subsidiary Company	
Net Assets	\$ 50
1 \$ = Rs.50	

Consolidated Company	
Net Assets	Rs. 9,500
FCTR	Rs. 300

DTL on 300 @ 30% = 90

FCTR A/c	Dr	90	
	To DTL A/c		90



Deferred tax on elimination of unrealised profit

Company X
(Holding)



Company Y
(Subsidiary)

Cost to X = \$ 120,000

Sold to Y = \$ 140,000

Consolidated Accounts

Stock = \$ 140,000

Unrealised Gain = (\$ 20,000)

Net Stock = \$ 120,000

Tax Rate for X = 34%

Tax Rate for Y = 30%

Tax base of Inventory is \$ 1,40,000, however as per books it is \$ 120000 giving rise to temporary differences.



Solution

- The profit made by X on sale to Y would be eliminated
- Under IAS 12, a deferred tax asset would be recognised on the unrealized profit of \$ 20,000 based on Y's 30% tax rate i.e. \$ 6,000

- The accounting entry being
 - Dr Current Tax (income statement) \$ 6,800
 - Cr Current Tax (balance sheet) \$ 6,800
 - Dr Deferred Tax (balance sheet) \$ 6,000
 - Cr Deferred Tax (income statement) \$ 6,000



Maximum Reporting Gap

- Under IFRS

The difference between reporting date of the subsidiary and that of the parent should not be more than 3 months

- Indian GAAP



The difference between reporting date of the subsidiary and that of the parent should not be more than 6 months



Other Concepts

- **Uniform accounting policy** mandatorily required as per IFRS, unlike under *Indian GAAP*; if impracticable, disclosure of items where different policies followed
- **Third Carve Out under IND AS**- Choice to follow non-uniform acct policies/periods for associates, where alignment is determined to be impracticable.
- **Non controlling interest disclosed within equity**, separately from the owners of the parent, unlike under *Indian GAAP*; Disclosed separately from liability and equity of parent shareholder
- Under IFRS, 1 **subsidiary have 1 parent reporting entity only**, unlike under Indian GAAP as per Under ASI 24 (Definition of Control), an entity can be subsidiary of two entities



Other Concepts

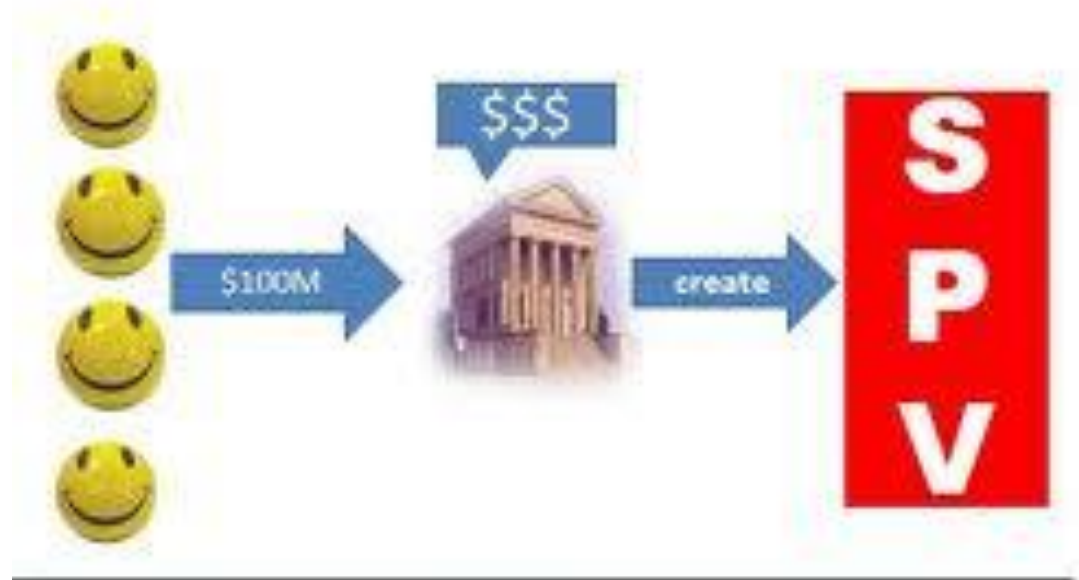
- Accounting of Investments in subsidiary, associate and jointly controlled entity in parents separate financial statement shall be
 - At Cost or
 - As Available for sale financial assets as described in IAS 39
- Under Indian GAAP, Should be accounted for in accordance with AS 13 (at cost as adjusted for diminution other than temporary in value of those investments)



Other GAAP Differences.....

IAS 27	AS 21
Detailed guidance in case of loss of control over subsidiary.	Not much on the issue.
No clarification	Provides clarification regarding inclusion of notes appearing in the separate FS of the parent and its subsidiaries in CFS.
Not dealt	Provides clarification regarding disclosure of parent's share in post-acquisition reserves of a subsidiary.
Concept of SPE	No guidance on consolidation of Special Purpose Entities (SPEs)
Does not mandate preparation of separate financial statements.	Consolidated Financial Statements are prepared in addition to separate financial statements.





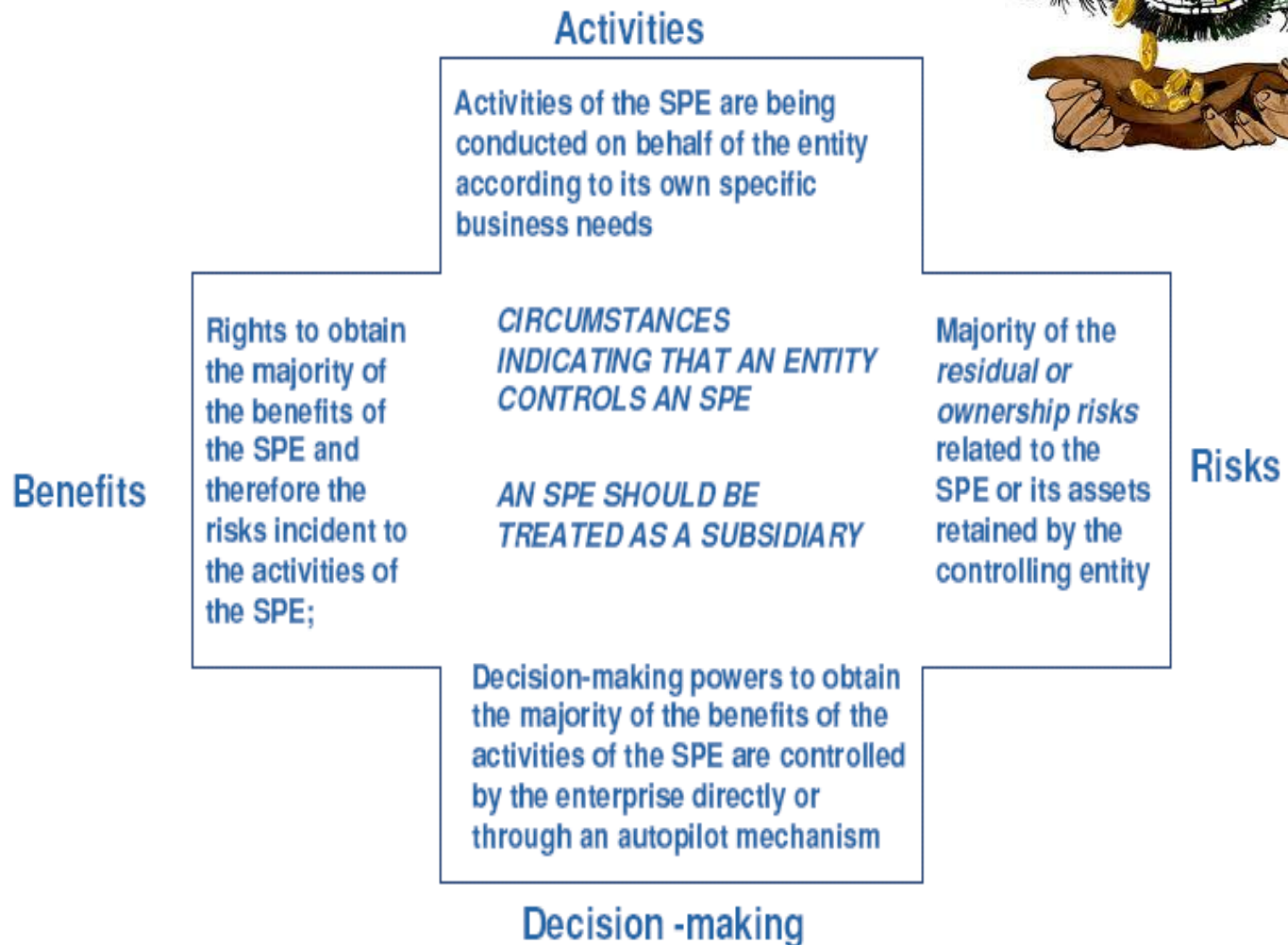
Objectives behind formation of an SPE

1. To carry out lease transactions
2. To carry out R & D
3. To carry out Securitisation Transactions
4. To finance a particular activity
5. To circumvent some tax / corporate law requirement

Features of SPE :-

- Auto-pilot arrangements that restrict the decision-making capacity of the governing board or management
- Use of professional directors, trustees or partners.
- Thin capitalization, the proportion of 'real' equity is too small to support the SPE's overall activities.
- Absence of an apparent profit-making motive,
- Domiciled in 'offshore' capital havens.
- Have a specified life.
- Exists for financial engineering purposes.
- The creator or sponsor transfers assets to the SPE, as part of a derecognition transaction involving financial assets

Special Purpose Entities – SIC 12



Accounting Principles



SIC 12 requires that an SPE should be consolidated when the substance of the relationship indicates that the SPE is a subsidiary.

For consolidation:-

- follow usual procedures
- elimination of inter-company activity
- presentation of minority interests.

IAS 27 requires specific disclosures for subsidiaries that are consolidated for reasons other than majority of voting power. These disclosure requirements apply to subsidiaries consolidated under SIC 12.

Consolidation procedures

- Start consolidation – when control commences
- Combining the accounts of the parent and it's subsidiaries
 - Accounting Policy Adjustments
 - Line by Line Addition
 - Inter-company Transactions / Balances
 - Unrealised Profit Elimination
 - Other Adjustments
- Elimination of parent's investment
- Disclose minority interests separately
- Base on present ownership interests
- Stop consolidation – when control ceases



Maintenance of Two books of Accounts



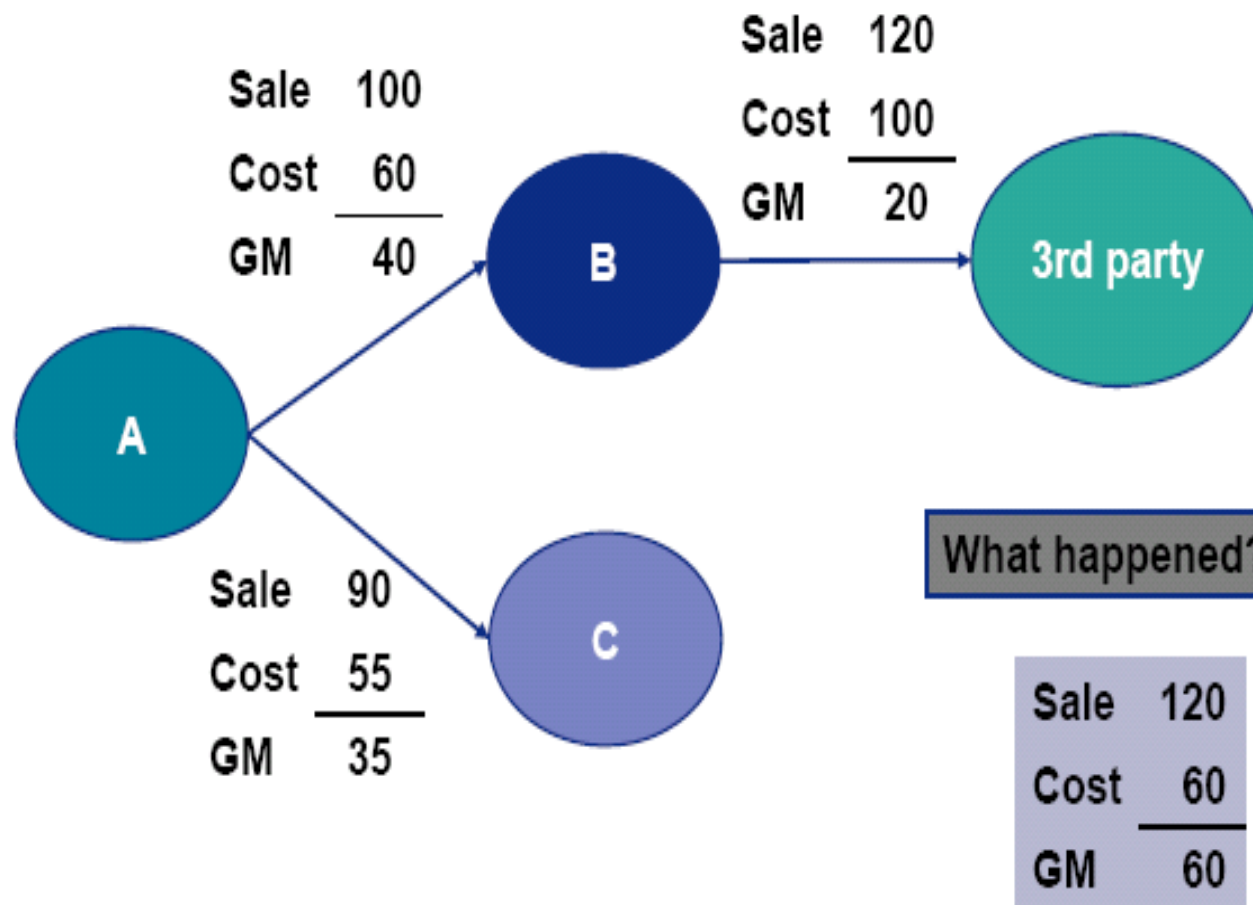
- Standalone books of Subsidiary at carrying values
- Fair Value Books for the purposes of consolidation.

Consolidation – Example

- ◆ Group consists of entity A and its subsidiaries B and C
- ◆ B has a loan with A of 100

	A	B	C	Total	Eliminations	Group
PPE	100	50	30	180		180
Shares in subsidiaries	500	-	-	500	-500	-
Intercompany receivables	100	-	-	100	-100	-
Receivables	-	400	300	700	-	700
Intercompany debt	-	-100	-	-100	100	-
Debt	-100	-50	-130	-280		-280
Equity	-600	-300	-200	-1,100	500	-600

Consolidation – Elimination of inter-company purchases and sales



First time Adoption

- On the date of transition
 - Identify all the entities which may be required to be consolidated
 - Restate the opening balance sheet for all the entities as per IFRS 1
 - Then proceed for consolidation



Step acquisitions

- Change in accounting for **step acquisitions**
- A owns an investment in B
- B = associated comp to A (i.e. A doesn't control B)
- If A increase its stake & gains control over B it must
 - Determine fair value of associate
 - Recognise profit/loss in income statement
 - Follow the provisions of IFRS 3
 - Cost would include fair value of B



Step acquisition – illustration

- A owns 35% stake in B at 31 Dec 2007
- Book value = Rs 2,500
- Buying additional 40% on 31 Dec 2007 at Rs 8,000
- Fair value (FV) of total B = Rs 10,000

31 Dec 2007

- A recognise gain of Rs 1,000 $[(35\% \times \text{Rs} 10,000) - \text{Rs} 2,500]$
- A accounts for 40% purchase under IFRS 3
 - FV of all of B = CU10,000 and FV of 75% of B = CU7,500
- Subsequent purchases = equity transaction

Loss of Control

A owns 60% of B On 1 January 20Y0 A disposes of 20% of B for Rs. 400 and loses control.

Carrying amount of NCI of B on 1 January 20Y0 is 700.

Carrying amount of net assets of B on 1 January 20Y0 is 1,750.

Fair value of remaining 40% is 800.



Loss of Control



Disposal of the 20% interest is recorded as follows

Dr. Cash 400

Dr. Non-controlling interest 700

Dr. Investment in B 800

Cr. Net assets of B (including goodwill) 1,750

Cr. Gain on disposal 150

Gain is based on the following calculation

Gain on 40% retained 100 ($800 - (40\% \times 1,750)$)

Gain on 20% disposed of 50 ($400 - (20\% \times 1,750)$)

Total gain 150

Assuming that the remaining 40% represents an associate, the fair value of 800 represents cost on initial recognition and IAS 28 applies going forward.

Disclosures.

- the nature of the relationship when the parent owns $< 50\%$ Voting Power,
- the reasons why the ownership $> 50\%$ Voting Power does not constitute control,
- the reporting date of the financial statements of a subsidiary that is different from that of the parent with reasons,
- the nature and extent of significant restrictions to transfer funds to the parent.
- Disclosures required in separate financial statements that are prepared for a parent that is permitted not to prepare consolidated financial statements: [IAS 27.41]
- the fact that the financial statements of a subsidiary have been prepared on the basis of the exemption from consolidation has been used; the exemption from incorporation or residence of the entity whose consolidated financial statements have been prepared with IFRS have been produced for public use; and the consolidated financial statements are obtainable,
- a list of significant investments in subsidiaries, jointly controlled entities, and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held, and
- a description of the method used to account for the foregoing investments.



IAS 28 – Associates – Def'n

- Associate: an entity in which an investor has significant influence but not control or joint control. A holding of 20% or more of the voting power (directly or through subsidiaries) will indicate significant influence.
- (a) representation on the board of directors or equivalent
- participating entity;
- (b) participation in policy-setting processes, including
- distributions;
- (c) relative importance of transactions between the
- (d) exchange of personnel management, or
- (e) provision of essential technical information.

IAS 28 – Associates - Scope



1. This Standard applies to accounting for investments in associates. However, shall not apply to investments in associates held by:
 - (a) venture capital organizations, or
 - (b) collective investment institutions, investment funds or other similar entities,
including funds related to insurance investments

Applying the Equity Method of Accounting

Basic principle. Under the equity method of accounting, an equity investment is initially recorded at cost and is subsequently adjusted to reflect the investor's share of the net profit or loss of the associate. [IAS 28.11]

Distributions Distributions received from the investee reduce the carrying amount of the investment.



IAS 28 – Associates – GW and Adj

- **Implicit goodwill and fair value adjustments.** Any difference between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate is accounted for like goodwill in accordance with [IFRS 3 Business Combinations](#).
- Appropriate adjustments to the investor's share of the profits or losses after acquisition are made to account for additional depreciation or amortisation of the associate's depreciable or amortisable assets based on the excess of their fair values over their carrying amounts at the time the investment was acquired. [IAS 28.23]

IAS 31 – Joint Ventures



- Joint control: the contractually agreed sharing of control over an economic activity. Joint control exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the venturers.
- *Jointly Controlled Operations* involve the use of assets and other resources of the venturers rather than a separate entity.
- *Jointly Controlled Assets* involve the joint control, and often the joint ownership, of assets dedicated to the joint venture. Each venturer may take a share of the output from the assets and each bears a share of the expenses incurred.
- *Jointly Controlled Entity* is a corporation, partnership, or other entity in which two or more venturers have an interest, under a contractual arrangement that establishes joint control over the entity. [IAS 31.24]



Two methods for JV

IAS 31 allows two treatments of accounting for an investment in jointly controlled entities – except as noted below:

- proportionate consolidation [IAS 31.30]

- equity method of accounting [IAS 31.38] -

Recognising a proportionate share of asset and liability is not in sync with the Framework, which defines asset in terms of exclusive control and liabilities in terms of present obligations

Any Questions.....



The Journey



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